Name _____ Date _____ Class _____

STUDY GUIDE Chapter 6, Section 1

For use with textbook pages 137–140

PRICES AS SIGNALS

KEY TERMS

price The monetary value of a product as established by supply and demand *(page 137)*

rationing A system under which an agency such as government decides everyone's "fair" share *(page 139)*

ration coupon A ticket or receipt that entitles the holder to obtain a certain amount of a product *(page 139)*

rebate A partial refund of the original price of the product *(page 140)*

DRAWING FROM EXPERIENCE

When you buy a new shirt or pair of shoes, do you look at the price? Do you go ahead and buy the item or wait for the price to be reduced?

This section focuses on how prices make capitalism work.

ORGANIZING YOUR THOUGHTS

Use the chart below to help you take notes as you read the summaries that follow. Think about the advantages and disadvantages of prices.

Price System	
Advantages	**Disadvantages**

Name _____ Date _____ Class _____

STUDY GUIDE (continued) Chapter 6, Section 1

READ TO LEARN

Introduction *(page 137)*

A ***price*** is the value of a product in money. Price is determined by supply and demand. It is a signal that helps us make our economic decisions. Prices give information and provide goals to buyers and sellers. For example, high prices are signals for producers to make more and for buyers to buy less.

1. What do you think low prices communicate to producers? To buyers?

_____

_____

Advantages of Prices *(page 137)*

Prices work well as a way of allocating, or distributing, goods and services. In a market in which sellers compete for buyers, prices are neutral, which means that they favor neither the producer nor the consumer. Prices are flexible and adjust to unpredictable events such as weather, natural disasters, and wars. This flexibility allows the market economy to respond to change. In a free market economy, prices have no cost of administration, unlike a government-run market system. Prices are familiar and easily understood.

2. What characteristic of prices allows a new technology, such as personal computers, to enter the market and find its own price level? Explain.

_____

_____

Allocations Without Prices *(page 139)*

An alternate to the price system is ***rationing.*** With rationing, people receive a ***ration coupon,*** which is a ticket that lets the ticket holder to obtain a certain amount of a product. Many people think that rationing is unfair. Almost everyone feels that his or her share is too small. A second disadvantage is the high cost of administration. Coupons must be printed and workers have to be hired to give out the coupons and handle complaints. Rationing decreases people's desire to work and produce, since how hard a person works has no relation to the number of coupons the person receives.

3. List the three disadvantages of the rationing system.

_____

_____

_____

Name _____ Date _____ Class _____

STUDY GUIDE (continued) Chapter 6, Section 1

◘ Prices as a System *(page 140)*

Prices do more than give information to buyers and sellers. They help buyers and sellers allocate, or distribute, resources to meet people's needs. Here is an example of how this works. In the 1970s, higher oil prices affected producer and consumer decisions. Since prices for heating oil and gasoline were so high, consumers had less money to spend on other things. The market for full-sized automobiles felt the effects, since big cars use more gas than smaller cars. At first, automakers offered ***rebates,*** which are basically price reductions, for their large cars. However, people still bought fewer big cars than before. Auto factories closed, and workers lost jobs. As a result, automakers changed the allocation of their resources. They began producing more small cars than they had before. The process was natural and necessary for a market economy.

4. How did the higher prices in the oil industry affect automakers' decisions to allocate their resources?

_____

_____

Name _____ Date _____ Class _____

STUDY GUIDE Chapter 6, Section 2

For use with textbook pages 142–148

THE PRICE SYSTEM AT WORK

KEY TERMS

economic model A set of assumptions and/or relationships that can be listed in a table, illustrated with a graph, or even stated algebraically *(page 143)*

market equilibrium A situation in which prices are relatively stable, and the quantity of goods and services supplied is equal to the quantity demanded *(page 143)*

surplus A situation in which the quantity supplied is greater than the quantity demanded at a given price *(page 144)*

shortage A situation in which the quantity demanded is greater than the quantity supplied at a given price *(page 144)*

equilibrium price The price that "clears the market" by leaving neither a surplus nor a shortage at the end of the trading period *(page 144)*

DRAWING FROM EXPERIENCE

Have you ever had a *surplus* of an item—rubber bands, for example? Have you ever had a *shortage* of notebook paper? What do you think economists mean by these terms?

In the last section, you read about the nature of pricing. In this section, you will read about how prices are determined and why they change.

ORGANIZING YOUR THOUGHTS

Use the table below to help you take notes as you read the summaries that follow. Think about what happens when there are surpluses and shortages of certain products.

The effects on	Surplus	Shortage
Prices		
Demand		
Supply		

Name _____ Date _____ Class _____

STUDY GUIDE (continued) Chapter 6, Section 2

READ TO LEARN

The Price Adjustment Process *(page 142)*

An ***economic model*** is a way of looking at the basic parts of an economic process. Economic models use such things as tables, graphs, or algebra equations to show things simply. One example of an economic model combines a supply curve and a demand curve. This model shows how the actions of buyers and sellers work together toward ***market equilibrium,*** which is a situation in which prices do not change much. A model may show, for example, that suppliers produce 11 CDs and price them at $25 each. At that price, they sell only one CD, leaving an extra amount, or ***surplus,*** of 10 CDs that do not get sold. The surplus causes the price to decrease—a little if the surplus is small and a lot if it is large. Therefore, suppliers lower the price and charge $10 a CD. When the price becomes lower, the CDs sell out right away, producing a ***shortage,*** which means that there are not enough CDs for all the people who want to by them. Now, because the CDs are selling so well, producers wish they had charged a higher price for their product. So during the next trading period, prices and the supply both go up. Suppliers sell for $15, which turns out to be the equilibrium price. An ***equilibrium price*** is a price that leaves neither a surplus nor a shortage and "clears the market."

1. What might happen to cause new shortages of CDs and, as a result, a new equilibrium price?

_____

_____

Explaining and Predicting Prices *(page 146)*

A change in supply, a change in demand, or a change in both can cause a change in price. Think about farming soybeans. Bad weather can cause a shortage of soybeans. Because the demand for soybeans stays the same whether the supply is great or small, the price per bushel rises to $20. A bumper crop could mean that a farmer gets only $5 per bushel. So elasticity of demand also affects prices. When a change in supply happens at the same time as an inelastic demand, as in the case of soybeans, prices change greatly. When the same change of supply happens at the same time as a very elastic demand, the change is much smaller. A change in demand can also affect the price of a good or service. For example, when economic conditions or political unrest threaten, people tend to increase their demand for gold and drive up the price.

2. What do you think happens when the supply of gold increases dramatically during good economic times?

_____

_____

The Competitive Price Theory *(page 148)*

The theory of competitive pricing represents a set of ideal, not real, conditions and results. Even so, many markets come reasonably close to the ideal. For example, the prices of milk, flour, bread, and other food will be relatively similar from one store to another. When prices vary, it is usually because buyers are not well informed. For example, the price of gasoline is higher at stations near the expressway because many times travelers do not know where to go to get cheaper gas. However, markets only need to be a little competitive to distribute resources well. No agency needs to set prices because the market finds its own equilibrium. Also, the questions of WHO, WHAT, and FOR WHOM are answered by buyers and sellers.

3. Why might a well informed buyer purchase a product, such as bread, at a price higher than the equilibrium price?

_____

_____

Name _____ Date _____ Class _____

STUDY GUIDE Chapter 6, Section 3

For use with textbook pages 150–155

SOCIAL GOALS VS. MARKET EFFICIENCY

KEY TERMS

price ceiling A maximum legal price that can be charged for a product *(page 151)*

minimum wage The lowest legal wage that can be paid to most workers *(page 152)*

price floor Lowest legal price that can be paid for a good or service *(page 152)*

target price A price floor for farm products *(page 153)*

nonrecourse loan A loan that carries neither a penalty nor further obligation to repay if not paid back *(page 153)*

deficiency payment A check sent to producers that makes up the difference between the actual market price and the target price *(page 153)*

DRAWING FROM EXPERIENCE

What types of jobs have you held? Did you receive the minimum wage? Did you like getting paid the minimum wage? Why or why not?

In the last section, you read about how prices are established in the market. In this section, you will read about how the government sometimes sets prices to achieve a social goal.

ORGANIZING YOUR THOUGHTS

Use the chart below to help you take notes as you read the summaries that follow. Think about the different ways that government has tried to help farmers.

Program	Description
Commodity Credit Corporation	
Federal Agricultural Improvement and Reform Act	

Name _____ Date _____ Class _____

STUDY GUIDE (continued) Chapter 6, Section 3

READ TO LEARN

Distorting Market Outcomes *(page 151)*

Prices are sometimes set to achieve social goals. For example, some cities use rent controls, or a maximum price that people can be charged for rent, to make housing more affordable. This is an example of a ***price ceiling.*** But rent controls freeze a landlord's revenue and threaten his or her profits. So landlords change apartments into office buildings, since they can charge higher rents for office space than for apartments. As a result, a shortage of apartments appears for as long as the price remains fixed below the equilibrium price. Consumers may be left without housing even if they can afford to pay a higher price than the ceiling.

The ***minimum wage*** is the lowest wage that an employer can pay a worker. The minimum wage is an example of a ***price floor,*** or the lowest price that can be legally paid for a good or service. At the equilibrium price of labor, all the workers offering their services would have jobs. With a price floor above the equilibrium price, there are not enough jobs for all the workers.

1. What effects might a ceiling on the price of fast-food hamburgers have?

_____

_____

Agricultural Price Supports *(page 153)*

In the 1930s, the government established the Commodity Credit Corporation (CCC) to help keep agricultural prices from changing. The CCC allowed farmers to take out ***nonrecourse loans,*** which are loans that, under certain conditions, do not have to be paid back entirely. The nonrecourse loans allowed farmers to borrow in hopes of earning a lot of money for their crops. Then, if the price for the crops dropped below the ***target price,*** or the lowest price that farmers hoped to get, the farmers gave the government any leftover crops and did not have to pay back the entire loan. In this case, the target price is basically the same as a floor price. Later, the CCC offered ***deficiency payments,*** which are checks sent to farmers to make up the difference between the target price of farm crops and the price that farmers actually received. In return for deficiency payments, farmers had to promise to limit their production of the crops that were covered under the plan.

The Federal Agricultural Improvement and Reform Act of 1996 tried to make farm products respond more to market forces and depend less on government price supports. For seven years, producers of grains, cotton, and rice are allowed to raise any crop on any land. Cash payments take the place of price supports and deficiency payments. When the program ends in 2002, farmers will no longer get any payments. Economists are not sure whether this approach will be successful.

2. What may happen in 2002 if farm income is still low and Congress chooses the goal of economic security over efficiency?

_____

_____

When Markets Talk *(page 155)*

Markets are said to "talk" when their prices move up or down a large amount. For example, suppose the government raises income taxes for both businesses and individuals. Investors might sell their stocks for cash or trade them for gold. As the selling takes place, stock prices fall. At the same time, gold prices rise. Thus investors' actions affect stock prices. The change in stock prices "tells" the government that investors dislike its new policy.

3. Suppose just as many investors buy stock as sell it. How would stock prices be affected? What message would the market give the government?

_____

_____

_____